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SUBJECT: MINISTER EXPECTS FEDERAL BUDGET DEFICIT,
REGULATORS PREDICT RECESSION

REF: A. 08 CANBERRA 1302
B. 08 CANBERRA 1266

Classified By: Pol/Econ Officer Casey Mace for reasons 1.4 (b) and (d)

Summary

¶1. (C/NF) The Australian Government has accepted it is heading towards its first federal budget deficit in eight years, according to Federal Infrastructure Minister Anthony Albanese, but remains committed to a muscular fiscal policy to prevent a deep or protracted recession. In a private lunch meeting in Sydney January 9 with the Charge and Consul General, Albanese said that the government is already planning to further stimulate the national economy with a second infrastructure package that will be larger than the AUD 4.7 billion dollar package announced in December 2008 (ref. A). Two of Australia's key financial sector regulators told the Charge in separate meetings that Australia will not be able to avoid a recession in 2009, but that its economic consequences would be more predictable than the financial sector events of 2008. The Chairman of the Australian Securities and Investments Commission hopes the new SEC Chairwoman can visit Australia in early 2009 to finalize a mutual recognition agreement with the United States for financial market operators. The Charge's meetings with Albanese and regulators confirmed that a recessionary outlook is growing more pervasive in the GOA's economic circles. While most economists argue that a deficit is justified to stimulate the economy in the face of a looming recession, Prime Minister Rudd's Labor government will face political heat for breaking the eight-year streak of budget surpluses.
End Summary.

Infrastructure Round Two: Bigger Projects and More Dollars

¶2. (C/NF) Privately confirming what many economic commentators have predicted, Infrastructure Minister Albanese told the Charge January 9 that the federal budget was headed towards a deficit. The combination of shrinking revenue caused by slowing economic growth and increased government spending to stimulate the economy has eaten much of the government's budget surplus. Nonetheless, Albanese said the GOA is committed to further spending packages to shore up the economy even at the cost of a larger deficit. Albanese confirmed that the government is planning to announce a second, larger infrastructure package in the coming year. He explained that much of the first AUD 4.7 billion infrastructure package announced on December 12 (ref. A) was for projects to rail, road, and research facilities that were already in the pipeline. The government is planning to finance large new projects, like a major expansion to Sydney's metro transit system, in a second wave of infrastructure spending. Albanese said the federal government is hoping to attract private sector participation in financing the next set of infrastructure projects, but is prepared to bank roll the entire cost if necessary.

An Australian Recession

13. (C/NF) Ross Jones, the deputy chairman of the Australian Prudential Regulatory Authority (APRA), told us in a separate meeting that Australia will enter a recession this year. Jones said that the "worse is yet to come, but events will be more predictable" than the crisis that seized Wall Street and sank Lehman Brothers. He explained that even the more predictable recession facing Australia will inevitably lead to the collapse of some of Australia's larger companies, and a couple of Australian banks will have exposure. As the national regulator for banks, insurance, and pension funds, APRA keeps a close eye on the health of the financial sector.

Jones pointed out that Australia's four major banks remain healthy and successfully completed capital raisings in December. Citing Commonwealth Bank's acquisition of Bank West, Jones noted that the crisis has created opportunities for the big banks to acquire smaller banks in Australia. He expects this trend to continue, citing the potential that Queensland-based Suncorp will be acquired by one of Australia's major banks in the coming year. These acquisitions, together with the withdrawal of foreign banks from the market, will lead to greater concentration in the banking sector. The chairman of the Australian Securities and Investments Commission (ASIC), Tony D'Aloisio, provided a similar recessionary outlook in a separate meeting. D'Aloisio said that Australia is heading for a recession, but he expects it to be short and shallow.

Still Hungry for a Mutual Recognition Agreement

14. (SBU) D'Aloisio said that the GOA was still committed to executing a mutual recognition agreement for financial market operators with the United States. A framework arrangement unveiled at a joint press conference with SEC Chairman Christopher Cox in August 2008 represented the first phase of the agreement. The SEC and ASIC agreed to defer completion of the second phase, authorizing specific stock exchanges and broker-dealers to operate in the counterpart market without needing to comply with additional regulations, until after the new U.S. administration assumes office. D'Aloisio said that he has written the incoming SEC Chairwoman to urge her to make the mutual recognition agreement a priority, and hopes she will be able to visit Australia in early 2009 to complete the agreement. D'Aloisio pointed out that the United States is Australia's largest investor and remains a critical source of capital for the Australian economy. As a result, a mutual recognition agreement that reduces regulatory barriers to investment remains a top ASIC priority.

A Principle-Based Approach to Executive Compensation

15. (SBU) Ross Jones confirmed that his regulatory agency, APRA, had already been working on a new policy of principles for executive compensation before the financial crisis set in last year. One key aspect of the policy is to link executive remuneration to longer-term performance indicators in order to temper high-risk behavior. Jones said that because the GOA is participating in the G-20 working group on executive compensation, it has decided not to announce any Australia-specific policy measures until after the G-20 concludes its work on the issue (Ref. B).

Comment: Deficit-Spending Will Demand Political Courage

16. (C/NF) Over the last several election cycles, the Liberal Party relentlessly--and until the last election successfully--portrayed itself as the more responsible economic manager, in part because it paid off Australia's national debt in 2001 and consistently delivered federal budget surpluses. No matter how compelling the case for economic stimulus, reversing the trend of budget surpluses and dropping into deficit will expose the Labor government to intense criticism from the opposition Liberal Party. Indeed, opposition leader Malcolm Turnbull jumped all over Prime Minister Rudd when he foreshadowed the possibility of deficit spending during a November parliamentary debate. A budget

deficit will spark fierce political controversy, but it is unlikely in the short-term to dent Rudd's popularity among a populace that is more concerned about jobs and pensions that are tied up in a sinking sharemarket.

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